

**Federal Bar Association
Securities Law Committee
Executive Council**

January 26, 2011

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Hon. Scott Garrett, Chairman, Subcommittee on Capital Markets
Hon. Maxine Waters, Ranking Member, Subcommittee on Capital Markets

RE: Funding for the Securities and Exchange Commission

Members of Congress:

We the undersigned are senior securities law practitioners, academics and officers of financial services and other organizations with decades of experience supporting the Securities and Exchange Commission's efforts to provide investor protection and honest markets. Many of us are former SEC senior officers, and many of us now represent or have represented substantial private sector clients in sophisticated matters before the SEC. We are all members of the Executive Council of the Securities Law Committee of the Federal Bar Association.

We write in our personal capacities in support of **(i)** a substantially increased appropriation for the SEC – paid for entirely through the SEC's longstanding registration fee mechanism, *at no expense to the American taxpayers and with absolutely no deficit impact*, or preferably **(ii)** the adoption for the SEC of the same funding model that Congress has used successfully for decades for the nation's banking regulators.

Let us acknowledge at the outset that we know there are many different views in Congress concerning Dodd-Frank and how it should be implemented. But protecting America's investors (large and small) from investment fraud, restoring integrity to the markets, and encouraging capital formation for America's businesses by drawing investors back into the

markets are priorities too important to sacrifice. For America's capital markets to maintain their dominance on the world financial stage, they need a strong, smart and effective regulator, and this requires adequate funding.

1. The SEC's Situation Is Critical. In an economy desperately needing investor confidence to promote capital formation and economic growth, the regulator of our capital markets is running almost on empty. The SEC's Enforcement Division is cutting back on its investigations, letting vacancies in important agency programs go unfilled, and cancelling technology upgrades needed to process the terabytes of data it gets each month. In the wake of Madoff, its Inspections Office is being forced to cut the number and frequency of its examinations of financial firms, which were already very infrequent due to historic underfunding of the agency. Its acclaimed plan to bring in Wall Street trading experts with the sophistication to understand and appropriately respond to today's complex trading and markets, including the new technologies and strategies that may have had a role in last year's "flash crash," cannot achieve its promise without funding.

This is not about funding Dodd-Frank. This is instead about maintaining at acceptable levels the core activities that have been at the heart of the SEC's Congressional mandate for many decades. The current SEC budget freeze has hit not only during the worst crisis our markets have faced in 80 years but also after years of effectively flat or declining SEC budgets (after adjusting for escalating fixed costs). And all the while, over a short period, trading volume has more than doubled, the number of investment advisers and the funds they manage have grown over 50%, investment products have become bafflingly complex, and split-second computer-driven trading has come to dominate our markets.

Investors sidelined with decimated 401(k)'s will be unwilling to again risk their capital if Wall Street's cop-on-the-beat increasingly comes to be seen by the public as a cop-on-furlough. Investor perceptions are critical, and without the return of individual investors and the conservative investment funds that hold much of their remaining wealth, America's road to economic recovery will be far longer and more difficult. Regardless of differing views about certain Dodd-Frank provisions, America's businesses, which now more than ever need to aggressively draw investment capital, will surely be hurt by any investor perception that lack of funding is sharply curtailing the SEC's ability to protect investors and maintain market integrity.

2. An Appropriation With No Taxpayer Dollars and No Deficit Impact. What is often forgotten in discussions about SEC funding is that *the American taxpayers pay absolutely nothing to run the SEC each year*. Over a decade ago, Congress wisely put the SEC on an entirely "self-funded" program. Under this program, the SEC carefully calibrates its various securities registration and filing fees several times a year to assure that these "user" fees will always pay for 100% of the SEC's annual budget in the amount appropriated. Under Section 31(a) of the Securities Exchange Act, as amended in 1996 (Pub. L. 104-290, §405(a)), the SEC must "collect transaction fees and assessments that are designed to recover the costs to the Government of the supervision and regulation of securities markets and securities professionals,

and costs related to such supervision and regulation, including enforcement activities, policy and rulemaking activities, administration, legal services, and international regulatory activities.”¹

There has been no serious objection over the years to this 1996 Congressional determination to have the SEC fund its budget entirely through registration and filing fees, and the amounts assessed have been miniscule relative to the transactions involved. And while a slight increase in these very small fees to cover needed SEC funding will in no way hinder capital formation, the alternative of a perception of inadequately regulated securities markets will surely deter investors from risking their capital and thereby stall economic growth. A substantially increased SEC appropriation paid for with the successful and decade-old SEC self-funding mechanism would *require no tax dollars* whatsoever, would *add nothing to the deficit*, and would *need no offset*.

3. Alternative of Adopting the Banking Agency Model for the SEC. Over the years, many have suggested putting the SEC on the same footing as the federal banking agencies by adding to the SEC’s existing “self-funding” something new – the ability to “self-budget.” Self-budgeting, which the self-funded federal banking agencies have done for many years, lets the banking agencies set their own budgets on a timely and adequate basis, and without getting lost in the inevitable complexities of the annual appropriations process. This lets the banking agencies in times of crisis respond quickly to changes in staffing and other program needs and to engage in long-range (multi-budget-year) planning by setting their own budget levels (self-budgeting), and then paying their own way through user fees (self-funding).

Of course, while benefiting from a self-budgeting process, the SEC will always remain subject to Congressional oversight. If Congress is concerned, it can call hearings to demand explanations, and if still not satisfied Congress can legislate to correct any perceived problems. The banking agencies remain keenly aware that they must use their self-budgeting power prudently, or Congress will modify it or take it away entirely, and the SEC would be just as mindful of this reality. Congress’ determination to put the banking agencies on this funding basis has proven to be a success story over many years, and it would be just as successful a means for funding the SEC.

The situation presently confronting the SEC is indeed serious – with frozen funding levels forcing curtailment of inspections, enforcement and other vital activities, and all at a time of globalized capital markets, more complex and opaque instruments than ever before, and electronic trading techniques that require expertise and intensive broad-based monitoring and evaluation. The present dilemma underscores vividly why continuing to involve the SEC in the uncertainties and inevitable delays necessarily inherent in the annual appropriations process is not in the best interest of American business or investors. Congress has long recognized that the SEC is woefully underfunded, and it has already explicitly authorized a doubling of the SEC’s budget over five years. With the SEC already funding itself through miniscule user fees and not through tax dollars, it makes sense to simply adopt for the SEC the self-budgeting approach that

¹ This 1996 statute requires the SEC to cover its budget solely through registration and filing fees. The amounts the SEC’s enforcement staff collects in disgorgement of illegal profits and penalties are paid to harmed investors when they can be located and otherwise to the Treasury. Thus, the SEC’s law enforcement determinations are made independent of any consideration of its budgetary needs.

has worked so efficiently and for so long for the banking agencies – for the good of investors, the health of our trading markets, and the encouragement of capital formation at a time when it is so seriously needed.

Thank you for your consideration of our views on this critically important subject. If we may be of further assistance, please contact us through our chairman Stephen Crimmins at 202.778.9440 or at stephen.crimmins@klgates.com.

Very truly yours,

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